



*Michael C. Schlachter, CFA
Managing Director & Principal*

June 4, 2008

Ms. Anne Stausboll
Interim Chief Investment Officer
California Public Employees' Retirement System
400 P Street, Suite 3492
Sacramento, CA 95814

Re: Annual Review – Securities Lending – Open Session Item 7a

Dear Anne,

You requested Wilshire's opinion regarding Staff's annual review of the Securities Lending program. This program has been extremely lucrative for the total fund over its lifespan, despite the current unrealized loss in the collateral pool.

CalPERS' Securities Lending program has generated almost \$1.2 billion in total net income to the PERF over its history (through today) and continues to grow in proportion to the size of the total portfolio. CalPERS Staff have taken a judicious approach to securities lending, focusing on the most profitable securities in the portfolio, and have been able to enter into some unique transactions due to the size of the lendable pool CalPERS has to offer. For example, the move into auction-based programs has allowed CalPERS to maximize its profit from each transaction and avoid pursuing lower yields in the market. We recommend no changes to this program at this time.

At the current time, there is a significant unrealized loss in the collateral pool for this program. The significant dislocation in the credit markets had a large impact on the credit spreads demanded by investors for some of the instruments CalPERS has purchased, resulting in a rapid drop in prices for some instruments. We note that none of these investments have had an increase in defaults, and are currently expected to pay investors the par amount over the next one to two years. As a result, barring any change in default rates, we expect that the unrealized loss will dissipate as these bonds mature.

As you are aware, Wilshire conducts due diligence on behalf of the Investment Committee on all internally-managed programs at least annually. To date, the securities lending program and collateral pool have been included in the annual review of the Internal Fixed Income team. Per our conversation today, and in light of the tremendous growth in the size of this program over the last few years, Wilshire will conduct a separate due diligence review of the securities lending program and collateral pool on at least an annual basis going forward.

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If you have any additional questions, please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink, appearing to be "Michael" followed by a stylized surname, with a long horizontal flourish extending to the right.